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RUEHMN/AMEMBASSY MONTEVIDEO 2411
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RUEATRS/DEPT OF TREASURY WASHDC
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STATE FOR WHA/FO, WHA/BSC, E, EEB
STATE PASS USTR FOR KATE DUCKWORTH
STATE PASS FED BOARD OF GOVERNORS FOR ROBITAILLE
NSC FOR TOMASULO
TREASURY FOR JHOEK
USDOC FOR 4332/ITA/MAC/WH/OLAC
USDOC ALSO FOR 3134/USFCS
STATE PASS EXIMBANK
STATE PASS OPIC FOR DEMROSE, NRIVERA, CMERVENNE
USAID FOR LAC/AA

E.O. 12958: N/A

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SUBJECT: BRAZIL: U/S JEFFERY'S MEETING WITH CENTRAL BANK PRESIDENT
MEIRELLES, AUGUST 21, 2007, SAO PAULO

SENSITIVE BUT UNCLASSIFIED - PLEASE PROTECT ACCORDINGLY

SUMMARY

11. (SBU) Under Secretary for Economic, Energy, and Agricultural Affairs Reuben Jeffery III met August 21 in Sao Paulo with Henrique Meirelles, President of Brazil's Central Bank. Meirelles commented on the recent global market turbulence and used the relatively mild reaction by Brazilian markets to illustrate the soundness of the economic fundamentals of the Brazilian economy. While noting the resilience of the Brazilian economy, he stated that infrastructure remains an area of present and future concern, and he expressed interest in learning from the U.S. experience in attracting private investment for large infrastructure projects. End Summary.

12. (U) Participants:

U.S.

Under Secretary Jeffery
Consul General (CG) Thomas J. White
Lisa Kusbiske, WHA/EPSC
William McIlhenny, S/P
James Story, ECONPOL Chief Sao Paulo
Thomas Pierce, E
Peter Higgins, POL Sao Paulo (notetaker)

Brazil

Central Bank President Henrique Meirelles
Paulo Vieira da Cunha, Director, International Affairs
Mario Toros, Director, Monetary Policy
Alexandre Tombini, Director of Norms and Organization of Financial

Systems

13. (SBU) Central Bank President Meirelles began the meeting by noting that global and Brazilian financial markets, struck by turbulence the week of August 13, were operating much better and had recovered some of their initial losses. (Note: Subsequent to this meeting, the stock exchange, Bovespa, turned in a strong performance and by August 27 had recovered all the losses it had suffered during the crisis. End Note.) Meirelles said the measures announced August 17 by the U.S. Federal Reserve had helped restore stability, and that while the situation was still unfolding, financial markets were improving. He further opined that it remained to be seen whether everything worked as expected; in other words if the losses would be shared by industrial concerns and not shouldered entirely by financial enterprises and institutions. U/S Jeffery noted that excessively low risk premiums in the sub-prime mortgage market may have contributed to the reverses, but re-pricing is taking place.

BRAZIL'S ECONOMIC IMPROVEMENT

14. (SBU) Under Secretary Jeffery noted Brazil's sound fundamentals, which should help the country's markets weather the turbulence. Referring to his meetings in Brasilia with Finance Ministry officials, he noted that the country had seen "breathtaking" economic improvement in recent years, especially in achieving price stability. Meirelles recalled that Brazil suffered extremely high inflation between 1980 and 1994, with lower inflation thereafter punctuated by periodic spikes. Recent years have seen very low levels of inflation, including a remarkable 3.1% for 2006. The target for 2007 is 4.5 percent, and current inflation is well within this target, running below 3.7 percent. Other economic factors

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Meirelles offered as proof of the sound economy include a current account balance that is 1.3 percent of GDP, a modest (given the 1.3 trillion dollar economy) external debt of 30 billion dollars, and 160 billion dollars in exchange reserves held in Treasury bonds. Brazil is the world's fifth largest holder of U.S. Treasury bonds, and these reserves potentially offer the Brazilian government a mechanism by which to moderate any severe exchange rate fluctuations. Meirelles concluded that given these conditions, the Brazilian economy is better positioned than ever to ride out any market turbulence.

CHALLENGES AHEAD

15. (SBU) Brazil's economy is nonetheless facing a number of challenges, Meirelles acknowledged. He cited infrastructure - especially in the aviation sector - as an example and noted that Brazil also needed to improve roads, highways, railroads, and energy infrastructure in order to continue to expand economic growth.

16. (SBU) The Under Secretary expressed interest in the GoB's Growth Acceleration Program (PAC) and asked how much of it would be financed by private investment. Meirelles replied that of the PAC's three components - public direct investment, state-owned company investment, and private investment - the private-sector component hadn't taken off yet. There were a number of regulations and requirements imposed by the Government Accounting Board (TCU) that inhibited full private-sector participation, he said.

FINANCING INFRASTRUCTURE INVESTMENT

17. (SBU) In response to the Under Secretary's questions on how the United States could help Brazil with its investment climate issues and help make U.S. private investors aware of the opportunities available in Brazil, Meirelles said he was interested in learning from the U.S. experience with attracting private investment in infrastructure projects. "Besides the availability of capital, how does the U.S. foster growth in such investment?" Meirelles asked. CG

White mentioned OPIC financing and TDA assistance with feasibility studies as examples of USG programs that help the U.S. private sector engage with countries.

¶18. (SBU) Under Secretary Jeffery promised to share with Meirelles studies that have been done on this subject. He noted that the United States has been fortunate in the growth of development capital markets over the past five years, and in the increasing involvement of state and local government in assessing their important infrastructure deficiencies and bringing in private capital to help address those shortcomings. Private capital had been especially involved in toll roads and, to a lesser extent, airports. In Brazil, Meirelles stated, concerns remain about capitalization and the need for the government to set a minimum price, which is sometimes not accepted by the private sector. It is possible, he suggested, that the rules in Brazil are not open enough for international companies.

¶19. (SBU) In the U.S., U/S Jeffery explained, the rules were often transaction-specific. Even so, a specific process could be politically charged, and caution was necessary to ensure a fair, competitive, responsible process. CG White noted that a group of U.S. institutional investors would be visiting Brazil in early September, representing both private and public sector investment funds. Meirelles reiterated Brazil's interest in fostering cooperation so that Brazil could have access to American know-how and benefit from the transfer of U.S. technology. One way Meirelles

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could help Brazil learn from other countries' experiences, U/S Jeffery suggested, would be to consult his colleagues in the world of central banking, such as Bank of Italy Governor Mario Draghi.

BIOFUELS

¶10. (U) International Affairs Director Paulo Vieira da Cunha noted that Brazil would host the G-20 meetings next year and was planning to organize a seminar on clean energy for Central Bank Governors and Finance Ministers. U/S Jeffery briefly outlined U.S.-Brazil cooperation under the bilateral biofuels cooperation MOU in the areas of creating standards, making biofuels into commodities, and financing new and expensive technologies.

COMMENT

¶11. (SBU) Meirelles and his senior advisors appeared to be fully engaged and on top of Brazil's macroeconomic situation. Most important, Meirelles was frank about Brazil's weaknesses and vulnerabilities and eager to learn from the U.S and other countries to help Brazil's economy and financial sector. End Comment.

¶12. (U) This cable was cleared by Embassy Brasilia and by U/S Jeffery's delegation.

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